

STANDARD & POOR'S	RATINGSDIRECT

Research:

[Return to Regular Format](#)

Annual Review of 'AAA' Rated Municipalities

Publication date: 02-Sep-2003

Credit Analyst: Karl Jacob, New York (1) 212-438-2111; Andrew Clarke, New York (1) 212-438-2105

Since the June 2002 review of 'AAA' rated communities, nine municipalities have earned Standard & Poor's Ratings Services highest general obligation (GO) bond rating, and no 'AAA' rated issuer was downgraded during that period. The total number of municipalities with GO debt rated 'AAA' now stands at 63.

The 'AAA' rated additions include:

- Bernards Township, N.J.
- Birmingham, Mich.
- Cerritos, Calif.
- Edina, Minn.
- Glencoe Village, Ill.
- Harrison Village, N.Y.
- Manhattan Beach, Calif.
- Palm Beach, Fla.
- Troy, Mich.

Bernards Township, Cerritos, Glencoe Village, Manhattan Beach and Harrison Village achieved the 'AAA' GO ratings right out of the gate. Birmingham, Edina, Palm Beach and Troy's 'AAA' ratings were all achieved through rating upgrades.

The recent additions all displayed strengths in the key rating factors leading to their 'AAA' ratings:

- Proactive management;
- Low-to-moderate debt levels;
- Economies that have outperformed the region in recessions and expansions;
- Much higher than average wealth levels; and
- Strong financial policies and historically comfortable financial positions.

■ Stability Through The Recession

The stability of 'AAA' ratings is due in part to the following factors:

- 'AAA' revenue streams tend to be less economically cyclical – for example, they are less dependent on economically sensitive revenues compared to states, which are heavily dependent on personal and corporate income taxes; business; sales taxes and capital gains taxes, which feel the effects of an economic slowdown almost immediately.
- Municipal revenue streams, which rely on the more stable property tax and locally derived fees and charges, have shown remarkable resilience through this recession. The less sensitive revenue sources supports a significant share of operating budgets, allowing for a high level of revenue predictability.
- A major component of most 'AAA' rated communities revenue is the property tax. Despite the recession, property tax collections remain quite high, averaging in excess of 99% in Standard & Poor's 'AAA' municipalities, and in most cases tax collections have provided better-than-budgeted results as they continue to grow.

- The strong pace of new housing construction, fueled by low mortgage rates, combined with residential valuation appreciation and tax base growth, has in many instances provided better-than-budgeted revenues in areas such as permits, fees and charges. This has helped offset declines or stagnation in other revenue areas such as interest income and sales tax caused by a soft economy.
- Due to very high wealth, income and property valuation, most 'AAA' rated issuers receive very little state aid, and therefore haven't been materially hurt by state aid cuts.
- Sales tax revenues have performed better than expected, with collections in many instances experiencing actual declines of only a few percentage points over prior years.
- Most 'AAA' rated communities' reserve levels, on a percentage basis, were quite strong going into the current slowdown.

This is not to say that all municipalities are performing well. While Most 'AAA's as expected, are managing resources and needs despite the recession, a small number of larger 'AAA' cities are disproportionately feeling the stress. An example is the City of Dallas, Texas. While the city's 'AAA' rating was affirmed, the credit outlook was changed to negative in September 2002 reflecting financial and infrastructure challenges facing the city.

Dallas' financial position is under increasing stress due primarily to a significant decrease in sales tax revenues and the city's commitment to increase pay for police and fire personnel by 5% annually in fiscals 2004 and 2005, while attempting to minimize future tax rate increases. The financial stress will likely continue beyond fiscal 2003.

In addition, Dallas' infrastructure needs continue to mount as spending for maintenance has been deferred, necessitating a large \$579 million bond program approved by voters in May 2003. A rating downgrade remains possible should the city's current financial difficulties evolve into a multiyear structural concern. Despite the recent bond authorization, the city's mounting infrastructure needs could hasten a rating downgrade.

■ Proactive Management Approach

As previously mentioned, management is a key component in the rating process. Management of the 'AAA' rated communities has demonstrated a proactive approach to preserve financial position. Highlighted below are some of the many actions Standard & Poor's has observed:

- To absorb the loss of revenue, increased financial pressure and rising costs such as health care and public safety, a combined approach is being undertaken. There seems to be an attempt to balance budgets from a combination of staff reductions, hiring freezes, use of reserves, and some minor fee adjustments.
- There is little evidence pointing to wholesale, or large tax increases. While in some instances property taxes and certain fees and charges are increasing, large tax increases alone are not being viewed as a solution.
- Discretionary spending, and in some cases, capital spending is being scaled back.
- Very few budget-balancing efforts involve use of one-shot revenues.

A Case Study: Fairfield, Connecticut.

A good case in point is the town of Fairfield, Connecticut. Located in very affluent Fairfield County, many of the residents' income are heavily tied to the financial services industry in New York City. While the dissipation of capital gains caused by the stock market decline has severely affected Connecticut's budget, the town's revenue structure relies instead on the much more stable property tax, which comprises more than 90% of general fund revenues. Through the recession, management has been able to maintain property tax collections at 99%. The town receives limited state aid, and most aid is grant related.

Recent cut backs in state aid (\$1.2 million over 2 years) has been easily managed within the town's operating budget. Town spending has been kept below the rate of inflation without materially impacting service delivery. Officials have done a creditable job in managing the scope and scale one of the town's largest ever capital programs (\$180 million school renovation and expansion project),

through careful cost/benefit analysis and value engineering exercises, which have helped meet school needs, while at the same time integrating increased debt service costs into its existing manageable debt service structure.

Table 1 'AAA' Rated Municipalities (August 2003)										
Credit Name	State	Pop.	P/C EBI as % U.S.	Total MV	P/C MV	Gen FB%	Unres FB%	Cur DS%	Overall debt % mv	Overall debt p/c
Alexandria	VA	128,283	165	14,632,473	114,064	34	34	3	1.16	1,319
Avon	CT	16,314	211	2,391,551	146,595	10	9	9	0.87	1,276
Bedford Twn	NY	18,133	169	3,953,742	218,041	25	24	10	1.11	2,426
Bernards Twp	NJ	24,575	250	4,705,385	191,470	40	35	15	1.75	3,359
Birmingham	MI	19,291	314	4,134,446	214,320	24	19	10	2.62	5,615
Bloomfield Hills	MI	3,940	454	1,608,346	408,210	46	45	21	1.13	4,596
Bloomington	MN	85,172	150	9,608,215	104,472	37	37	12	2.36	2,484
Boca Raton	FL	74,764	220	11,614,994	155,355	29	28	17	1.88	2,925
Cambridge	MA	101,355	148	18,050,952	178,096	16	11	4	0.40	705
Cary	NC	104,214	156	10,908,711	104,676	99	82	5	1.94	2,029
Cerritos	CA	53,100	111	4,900,000	92,279	233	211	1	1.10	1,019
Charlotte	NC	604,676	125	60,887,128	100,694	27	16	23	2.66	2,679
Charlottesville	VA	40,999	89	2,896,033	70,637	18	16	4	1.39	979
Columbus	OH	711,470	100	38,038,582	53,465	11	9	18	3.76	2,012
Coral Gables	FL	42,900	204	6,465,849	128,911	6	5	4	0.82	1,241
Dallas	TX	1,203,050	120	66,483,637	55,263	10	9	14	2.91	1,610
Dover	MA	5,558	250	1,718,511	309,196	24	18	8	0.80	2,476
Durham	NC	194,405	103	14,358,250	73,857	16	10	10	3.53	2,609
Edina	MN	47,425	237	7,133,201	150,410	70	68	22	1.59	2,387
Fairfield	CT	57,340	226	10,403,152	181,429	9	8	7	2.13	3,870
Germantown	TN	39,279	196	3,863,671	98,365	58	49	25	2.20	2,168
Glencoe Village	IL	8,762	420	1,534,173	175,094	28	23	22	4.10	7,190
Greensboro	NC	223,891	113	16,972,650	75,808	31	16	9	1.48	1,120
Greenwich	CT	61,101	295	26,591,602	435,207	7	0	2	0.16	694
Harrison Village	NY	24,154	220	6,461,258	267,503	26	25	12	0.85	2,272
Hinsdale	IL	17,349	284	2,896,405	166,949	48	42	7	2.90	4,840
Indianapolis	IN	791,926	105	28,479,434	35,962	45	40	24	4.36	1,567
Irving	TX	194,407	144	14,589,186	75,045	19	16	12	6.59	4,942
Lincoln	NE	231,800	104	11,130,588	48,018	41	40	5	2.18	1,047
Lower Merion Twp	PA	59,850	288	8,525,534	142,448	28	27	12	2.13	3,029
Manhattan Beach	CA	33,850	248	6,365,175	188,041	49	46	4.8	2.10	3,947
Millburn Twp	NJ	19,765	288	4,311,445	218,135	33	18	5	1.94	334
Minneapolis	MN	382,618	114	25,871,985	67,618	20	20	24	3.99	2,701
Mountain View	CA	71,610	176	10,899,895	152,212	105	77	12	1.51	1,999
Naperville	IL	128,358	179	11,935,443	92,986	37	32	9	3.14	2,922
Needham	MA	28,911	182	5,457,974	188,785	13	8	7	0.49	928
Northbrook Vill	IL	33,435	241	5,313,313	158,915	45	40	9	2.79	4,436
Norwalk	CT	83,316	168	12,327,978	147,967	7	7	8	1.51	2,230
Omaha	NE	390,007	110	18,980,655	48,667	9	5	22	4.08	1,984
Overland Pk	KS	162,592	155	14,393,642	88,526	48	44	7	3.36	2,972

Palm Beach Twn	FL	9,676	440	8,152,038	842,501	47	45	4	0.50	4,242
Palo Alto	CA	60,835	245	11,609,915	190,843	59	51	3	2.01	3,835
Plano	TX	236,539	188	20,194,220	85,374	16	14	19	4.78	4,077
Princeton Twp	NJ	16,027	238	2,318,818	144,682	15	11	6	2.34	3,386
Raleigh	NC	276,093	122	27,938,392	101,192	47	38	8	1.78	1,799
Ridgefield	CT	23,920	263	5,729,720	239,537	10	9	7	2.59	6,194
Ridgewood Vill	NJ	24,936	231	3,839,567	153,977	22	10	4	1.08	1,664
Rochester	MN	88,858	118	4,573,648	51,471	41	40	5	2.30	1,186
Roswell	GA	79,334	174	8,105,687	102,172	60	43	15	1.87	1,908
Santa Monica	CA	87,954	184	13,491,852	153,397	81	24	5	2.65	2,804
Scottsdale	AZ	202,705	189	24,790,147	122,297	43	41	2	2.68	3,284
Seattle	WA	563,374	163	75,506,592	134,026	20	6	9	1.90	2,550
St Paul	MN	287,260	104	15,532,000	54,069	26	23	24	4.03	2,178
Stamford	CT	117,083	198	15,511,630	132,484	2	0	8	1.93	2,557
Sudbury	MA	16,841	234	3,068,276	182,191	10	5	17	1.66	3,028
Summit	NJ	21,131	274	4,203,149	198,909	37	27	12	1.99	3,968
Town & Country	MO	10,894	336	2,281,929	209,467	156	156	2	1.66	3,485
Troy	MI	80,959	179	11,911,394	147,129	44	37	7	1.67	2,460
Wellesley	MA	26,613	218	7,189,273	270,141	7	2	7	0.55	1,497
West Hartford	CT	61,045	174	5,163,970	83,547	8	8	8	1.94	1,680
Westlake	OH	31,719	173	2,938,968	92,656	132	90	17	2.57	2,382
Weston	MA	11,469	333	3,898,856	339,947	10	3	12	1.34	4,555
Winston-Salem	NC	185,776	104	14,821,500	79,782	20	13	10	2.18	1,706
Average (Mean)		143,571	202	13,088,360	159,293	38	31	11	2	2,657
Standard Deviation		218,074	79	14,650,744	121,077	39	35	6.5	1.17	1,279
Median		61,073	182	9,066,875	143,565	28	24	9	1.94	2,443
Figures based on the most available information.										

■ Behind The Ratings

Close examination of 'AAA' rated communities' ratios shows that neither size nor geographic location matter. Dallas has more than one million residents, while Bloomfield Hills, Mich. has fewer than 5,000 residents. However, both large and small population 'AAA' communities share important attributes, such as low unemployment rates and above-average wealth levels. Grouping the municipalities by size and region reveals for instance, that per capita market values and wealth levels tend to be higher in the northeast than in other regions. The fact that these two statistics move in tandem indicates a direct link between the wealth of a community and property values. Even though large cities generally have lower wealth levels, it is not impossible for them to achieve the highest rating category.

Standard & Poor's emphasizes four factors when assigning an 'AAA' rating to a municipality:

- Strong and proactive administrations;
- Effective debt management with moderate to low debt;
- A vibrant and diverse economy or participation in one; and
- Strong finances.

These factors combine both qualitative and quantitative factors.

Qualitative data include:

- The presence of an experienced management team with a history of conservative budgeting and successful management through all economic cycles;
- The scope and extent of financial responsibility for municipal services shared with other levels of government; and
- The extent to which a municipality can draw on alternative sources to finance operations.

Quantitative factors, on the other hand, provide the numbers and ratios helpful to financial analysis. These reveal:

- The ability to repay principal and interest (but not willingness to pay, which is a qualitative factor);
- An idea of the sufficiency of reserves; and
- Strength of the economy and other important information.

Together, the qualitative and quantitative factors provide insight into a community's ability to support its debt.

■ Administration

One of the most important factors in rating a community is the community's financial management team. A team must have strong, interactive relations with elected officials, favorable budgeting results, and a proven track record of managing through good as well as bad times. The management team must also have a strong grasp of its finances and an explicit plan for future capital outlays and development. Conservative and accurate budgeting is another important attribute of 'AAA' rated communities. These communities' management demonstrates the ability to manage resources, recognize potential revenue and or expenditure pressures, and react during the fiscal year to ensure maintenance of financial position.

■ Debt

'AAA' rated communities carry affordable and easily manageable debt ratios. The average overall debt per capita for the 63 'AAA' rated communities is a manageable \$2,657. Seven of the small municipalities exceed \$4,500 debt per capita, a function of very small populations. This is not a credit concern when debt to high market value and very high wealth levels are factored in. As a result of these smaller communities incurring higher debt per capita ratios and the increase in the number of 'AAA' rated municipalities, the 'AAA' average debt per capita has grown in recent years. Compared to five years ago, the median debt per capita for all 'AAA's' has grown from \$1,700 four years ago to \$2,443 now.

The fact that Standard & Poor's assigns 'AAA' ratings to nine municipalities with populations greater than 250,000 illustrates that issuers are not penalized by their size, or for providing those extra services, assuming the services fit within the budget. High debt-per-capita levels can also be offset by other factors. The Village of Glencoe, Ill.'s debt-per-capita level is high at \$7,190, but its wealth levels (as measured by per capita effective buying income) are well above the national average, at 420%.

The 'AAA' municipalities have low debt-to-market value averages, on average paying off approximately 70% of their long-term debt within 10 years. While such aggressive debt retirement schedules can increase fixed costs by accelerating repayment faster than need be, 'AAA' municipalities exhibit the economic strength and financial capability to support the rapid amortization. The median current debt service payment for all 'AAA' communities is about 9% of general fund and debt service budgets.

■ Economy

A municipality does not necessarily have to have its own dynamic economy in order to achieve a high-grade rating. Many of the 'AAA' rated communities, such as Bernards Township, N.J., Dover, Massachusetts, Glencoe Village, IL. and Bloomfield Hills, Mich. benefit from close proximity to major employment centers. The larger 'AAA' municipalities tend to support their own diverse economies. Dallas is home to the second busiest international airport in the country, as well as major corporate headquarters. Other 'AAA' rated municipalities that play host to corporate headquarters include Stamford, Conn. and Raleigh-Durham, N.C. The diversity of these economies provides the assurance that they will be able to weather a downturn in any one sector.

Some of the key ratios demonstrating a municipality's economic health include unemployment, the market value and trend of property valuations, and the relative wealth levels measured by effective buying income. High per capita property valuation represents a significant investment in property. In economic downturns, higher-valued properties typically retain valuation.

The town of Palm Beach, Fla.'s market value per capita is incredibly high at \$842,501 followed by Greenwich Conn. at \$435,307 and Bloomfield Hills, Mich., at \$408,210. The larger population 'AAA's tend to have much lower per capita market values, such as Columbus, Ohio, at \$53,465 and Indianapolis, Ind., at \$35,962. The average per capita market value for all 'AAA' rated communities is \$159,039, a hefty 22% increase from the previous year. Median per capita market value also strongly increased, up 20.5% or \$143,565.

Table 2 Grouping 'AAA's by State and Region							
Northeast		Midwest		West/Southwest		Southeast	
Connecticut	7	Minnesota	5	California	5	North Carolina	6
Massachusetts	6	Illinois	4	Texas	3	Florida	3
New Jersey	5	Michigan	3	Arizona	1	Virginia	2
New York	2	Ohio	2	Washington	1	Georgia	1
Pennsylvania	1	Nebraska	2			Tennessee	1
		Kansas	1				
		Missouri	1				
		Indiana	1				

There are some differences among the municipalities depending on population and location. Larger cities (those with more than 250,000 residents) have average per capita values of about \$72,328; smaller communities (those with less than 50,000 people) show average per capita values of \$223,019. This dramatic difference can best be explained by the relative homogeneity of smaller communities. Larger municipalities, by contrast, contain a mix of wealthy and poorer areas that tend to moderate per capita values. For instance, Avon, Conn., with a per capita market value of \$146,595, is a wealthy residential suburb of Hartford.

In contrast, Indianapolis, Ind., is a diverse city with a per capita market value of \$35,962. Northeast municipalities have higher per capita valuations reflecting the generally higher housing values in Pennsylvania, New Jersey, Connecticut, and Massachusetts, as well as higher incomes. The relationship between per capita effective buying income and market value per capita indicates that higher incomes are associated with higher property values.

Additionally, most 'AAA' municipalities share strong employment and income figures, which can offset other areas of weakness. Charlottesville, Va. has an unemployment rate well below the national average, which helps offset a per capita wealth level that is 93% of the U.S. average. The presence of the University of Virginia also assures Charlottesville of relatively strong employment in economic expansions as well as contractions

The average wealth levels in Charlottesville and Columbus, Ohio are also offset by the presence of large and well-regarded state universities. While the large student population depresses wealth levels, the intellectual capital helps create jobs and a dynamic economy. Just as the large university presence in the areas of Palo Alto, Calif. (Stanford), and Cambridge, Mass. (Harvard and MIT), help generate new businesses and jobs in those areas, Charlottesville (University of Virginia) and Columbus (Ohio State University) reap the benefits of significant university presence. Raleigh and Durham have higher-than-average wealth levels, but also benefit from the presence of Duke, Wake Forest, and the University of North Carolina. These three prestigious universities form an important base for the "Research Triangle" and a fast growing regional economy with high-paying jobs.

■ Finances

The fourth important factor is a municipality's finances, which are closely tied to the strength of the management team and the tax base's ability to generate revenue. Strong financial management, with

the ability to accurately plan and develop significant reserves is a common characteristic of highly rated municipalities. Average unreserved general fund balance, as a percentage of operating expenditure for all 'AAA' rated municipalities is very strong at 31%. The median unreserved fund balance is 24%. Given the stability of locally derived revenues, the strong fund balances provides a comfortable financial cushion and allows the 'AAA's great flexibility in dealing with unforeseen events. The strong financial profiles have allowed the 63 'AAA' rated communities to weather the current national economic slowdown.

■ Conclusion

The ratios of 'AAA' municipalities do not represent an exhaustive list of considerations in the rating process. They do, however, represent some of the most important characteristics contributing to the coveted 'AAA' rating:

- Strong administration;
- Manageable debt levels;
- Strong economies; and
- Financial flexibility.

Quantitative factors consist of numbers and ratios helpful for financial analysis. Qualitative factors provide depth, perspective, and context. Together, they impart the entire picture of a municipality. Scottsdale, Ariz., and Germantown Tenn. have strong management; Bloomfield Hills, Mich.'s extraordinary wealth levels offset its high debt per capita ratios; and Cambridge, Charlottesville, and Columbus host major universities but have lower per capita wealth levels consistent with large student populations.

Overall, Standard & Poor's 63 'AAA' rated municipalities, each unique, possess key factors that produce extremely strong capabilities to meet their debt obligations.

